Community Bankers’ Business Conditions Outlook Tied to Yield Curve

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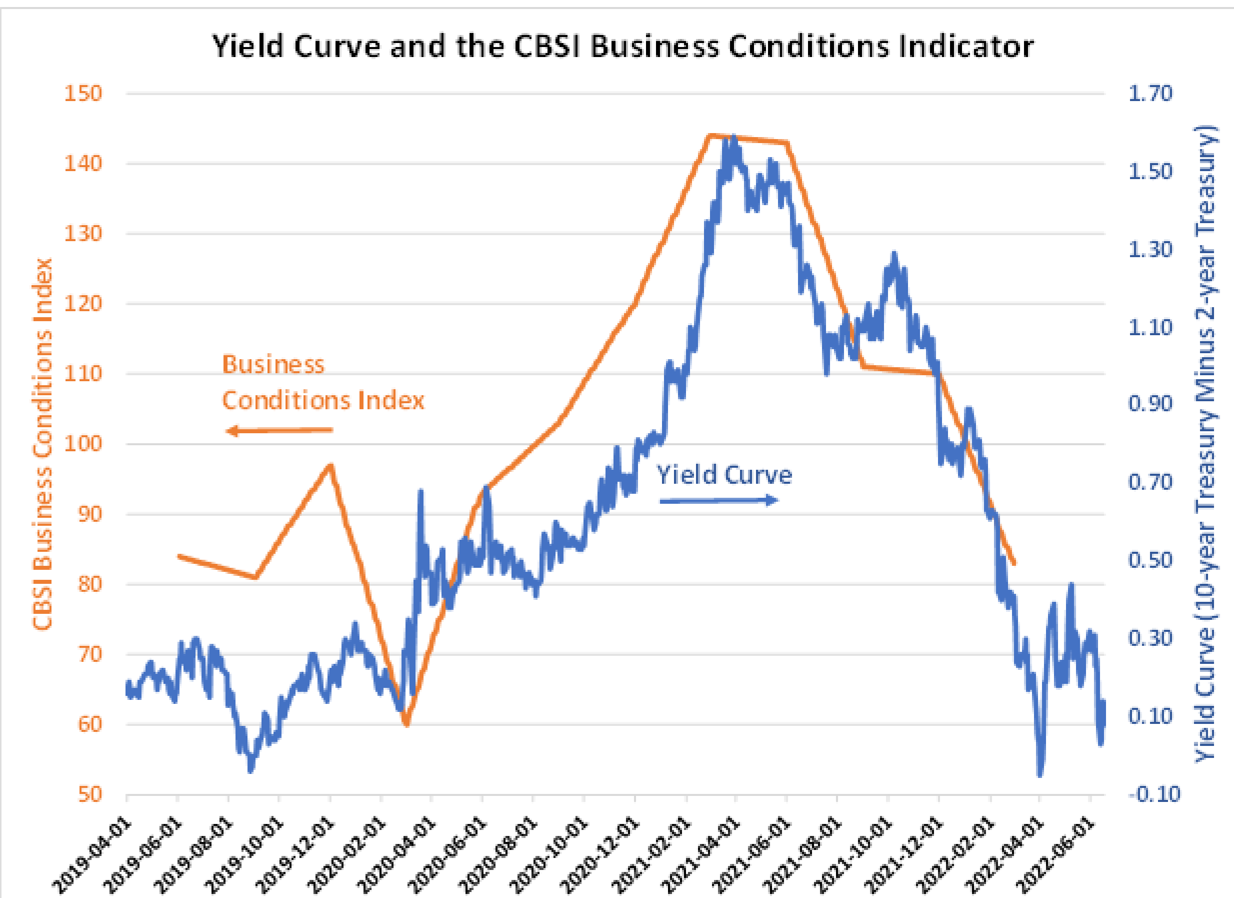
The slope of the U.S. yield curve, or the difference between the yield on the 10-year Treasury note and the 2-year Treasury bill, appears to be an important indicator of community bankers’ expectations for future business conditions. As shown in the nearby chart, turning points in community bankers’ outlook for future business conditions strengthened when the yield curve widened and has weakened again as the yield curve has narrowed.



The business conditions indicator is one of seven components that comprise the CSBS community bank sentiment index (CBSI). Each of the seven indicators and the overall index are computed by subtracting the percentage of negative, or unfavorable, responses from the percentage of positive, or favorable, responses and then adding 100 so that 100 is the neutral level. For the business conditions indicator, values less than 100 indicate that community bankers expect a contracting, or slowing, economy whereas values above 100 signify future expansion.

This interesting relationship between the business conditions sentiment indicator and the yield curve suggests that the soon-to-be-released second quarter 2022 CBSI will likely show further deterioration in the business conditions component. Even though interest rates have increased markedly in recent weeks, the yield curve has stayed razor thin, with the difference between 10-year and 2-year Treasury securities now around 10 basis points. With the yield curve essentially flat, the historical relationship would infer that the next business conditions component of the CBSI will likely be 60 or less and may fall to the lowest level recorded since CSBS launched the CBSI in early 2019.

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